14.06 Presentation

Statement of Changes in Stockholders' Equity Presentation

The presentation of stockholders' equity (ASC 205) in a balance sheet may include as many as **seven categories**, presented in the following order:

- Preferred stock
- Common stock
- Additional paid-in capital
- Noncontrolling interest (minority interest)
- Retained earnings
- Accumulated other comprehensive income
- Treasury stock, at cost

Stock accounts are known as the **legal capital** of the corporation and are listed from the most senior security (the one entitled to dividends first) to the most junior. If a company has one class of preferred stock and one class of common stock, the preferred stock is listed first.

Preferred stock is shown at the total par (or stated) value of shares issued less shares held in treasury under the par value method. On the face of the balance sheet as part of the account name, the company must disclose:

- Par value per share
- Liquidation value per share (if different from par value)
- Dividend preference rate or amount per share
- Cumulative (if applicable)
- Participating (if applicable)
- Shares authorized
- Shares issued
- Shares outstanding

Common stock is also shown at the total par value of shares issued less shares held in treasury under the par value method. On the face of the balance sheet as part of the account name, the company must disclose:

- Par value per share
- Shares authorized
- Shares issued
- Shares outstanding

Additional paid-in capital is listed immediately after the stock accounts and includes all contributed capital in excess of the legal capital of the company. Some of the types of APIC are from:

- Preferred stock
- Common stock
- Retired stock
- Treasury stock
- Warrants
- Employee stock options (less deferred compensation)
- Expired stock options

Noncontrolling interest, sometimes referred to as the minority interest, arises when a reporting entity prepares consolidated financial statements that include a subsidiary in which the parent owns less than 100%. This may include an entity:

- With which the reporting entity has entered a business combination in which it acquired a majority of the equity shares, in which case the noncontrolling interest represents the minority portion not owned.
- That is a variable interest entity (VIE) in which it has a controlling financial interest but does not own a majority of the equity. In this case, the noncontrolling interest represents the equity of the consolidated VIE that is not owned by the reporting entity, generally a majority.

The noncontrolling interest of a consolidated subsidiary is initially recognized at its fair value on the date of the combination. In many cases, this will be measured at the market price of a single share multiplied by the number of shares held by stockholders other than the reporting entity. It will be adjusted for the noncontrolling interest's share in income, comprehensive income, and distributions.

The noncontrolling interest of a VIE will be determined in the same manner when the VIE is not a related entity. When the VIE is a related entity, however, the consolidation is reported using the VIE's book values, rather than fair values, and the noncontrolling interest is the portion of the VIE's reported equity that is not owned by the reporting entity.

Net income includes all components of income for both the reporting entity and all consolidated entities and is allocated between the portion attributable to the reporting entity and the portion attributable to the noncontrolling interest. Other comprehensive income, including components of the reporting entity and consolidated entities, is also allocated.

The noncontrolling interest is a component of stockholders' equity and is required to be presented in the equity section of the balance sheet.

Retained earnings is reported next. The details of the changes in the account are reported in a separate **statement of retained earnings**, which might appear as follows:

XYZ Corporation
Statement of Retained Earnings
For the Year Ended December 31, 20X3

Retained earnings, 12/31/X2 – as previously reported	$600
Prior period adjustment to correct inventory, net of $80 taxes	120
Retained earnings, 1/1/X3 – adjusted	720
Net income for the year ended 12/31/X3	260
Less dividends	(100)
Retained earnings, 12/31/X3	880

The next section is for **accumulated other comprehensive income (OCI) - (DENT)**, which reflects cumulative changes in net assets resulting from certain transactions not included in net income and not affecting retained earnings including:

- **D**erivative Cash flow hedges.
- **E**xcess adjustment of Pension PBO and FV of Plan assets at year end
- **N**et unrealized changes in the value of marketable securities
- **T**ranslation gains and losses from foreign currency

Tax effects may be reported on each of the accounts or in the aggregate for the section. In certain cases, the items included in this section may be debit balances, resulting in contra-equity accounts being reported.

Treasury stock is presented last on the balance sheet, but only for stock that is being held under the cost method (treasury shares held under the par value method are netted directly against the stock accounts presented earlier). It is always a contra-equity account. Included in the account name must be disclosures of:

- Number of shares held
- An indication that the shares are reported at cost

An example of the *stockholders' equity section* of the balance sheet follows:

XYZ Corporation
Stockholders' Equity
December 31, 20X3

Preferred stock, $100 par value, $105 liquidation value, 8% cumulative, 100 shares authorized, issued, and outstanding		$10,000
Common stock, $1 par value, 4,000 shares authorized, 1,000 shares issued, 900 shares outstanding		1,000
Additional paid-in capital		5,000
Noncontrolling Interest		400
Retained earnings		12,400
Accumulated other comprehensive income:		
Foreign currency translation gains	$1,800	
Net unrealized losses on available-for-sale securities	(300)	
	1,500	
Less taxes	(600)	900
		29,700
Less common stock in treasury, 100 shares at cost		(1,200)
Total stockholders' equity		$28,500

Assuming there are no dividends in arrears on preferred stock, the **book value** of the common stock is computed as follows:

Stockholders' equity	$28,500
Preferred stock liquidation value	(10,500)
Common stock equity	18,000/
Divided by common shares outstanding	900
Book value per common share	$20

Statement of Changes in Stockholders' Equity

When significant changes occur in stockholders' equity, companies are required to disclose them. Here is an example of such a statement taken from the financial statements of Marriott, International:

MARRIOTT INTERNATIONAL, INC. (DEC)
Consolidated statements of shareholders' equity

Fiscal Years 20X1
(In millions)

			Equity Attributable to Marriott Shareholders					
Common Shares Outstanding		Total	Class A Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock, at Cost	Accumulated Other Comprehensive Income (Loss)	Equity Attributable to Noncontrolling Interests
366.9	Balance at year-end 20X0	$1,585	$5	$3,644	$3,286	-$5,348	-$2	—
—	Net income	198	—	—	198	—	—	—
—	Other comprehensive loss	-24	—	—	—	—	-24	—
—	Dividends	-135	—	—	-135	—	—	—
9.5	Employee stock plan issuance	182	—	9	-137	310	—	—
-43.4	Purchase of Treasury stock	-1,425	—	—	—	-1,425	—	—
—	Spin-off of Marriott Vacations Worldwide Corporation	-1,162	—	-1,140	—	—	-22	—
333	Balance at year-end 20X1	($781)	$5	$2,513	$3,212	($6,463)	($48)	$—

Equity Securities Classified as Debt

Some financial instruments issued by an entity have characteristics of both debt and equity. ASC 480, *Distinguishing Liabilities from Equity*, requires financial instruments that embody an **obligation** of the issuing entity be reported as a liability. An obligation in this context is a duty or responsibility to transfer assets or issue equity shares. The obligation may be conditional or unconditional.

An example of an equity instrument that includes an obligation would be a put option issued by the entity. A put option entitles the holder to require to repurchase its equity securities. Settlement may be through:

- Physical settlement in which the full cash amount is transferred in exchange for all the shares.
- Net cash settlement in which cash is paid or received based on the difference between the option price and the fair value at exercise.
- Net share settlement in which shares are issued or reacquired with a total value equal to the difference between the option price and the fair value at exercise.

In some cases, these instruments will require the entity to issue shares for an amount greater than their fair value on the date of issuance or will be the recipient of a net settlement. In such cases, the instruments would be reported as assets.

Instruments that may be reported as liabilities or assets include:

- Mandatorily redeemable financial instruments;
- Obligations to repurchase equity shares by issuing assets; and
- Certain obligations to issue a variable number of shares.

Mandatorily redeemable instruments are always reported as liabilities unless redemption is only required upon liquidation or termination of the entity. An instrument that is redeemable only upon the occurrence of an event that is not certain to occur is not considered mandatorily redeemable. The instrument will be recognized as a liability when:

- The event has occurred;
- The condition is resolved; or
- The event has become certain to occur.

An **obligation to repurchase equity shares by transferring assets**, such as a forward purchase contract or a put option, is classified as a liability, unless it is an outstanding share, if two characteristics apply:

1. There is an obligation to repurchase the entity's equity securities or has an obligation that is calculated on the basis of the fair value of the shares; and
2. The obligation does, or may, ultimately require settlement by the transfer of assets.

An instrument that gives the holder the right to require the entity to transfer assets is always reported as a liability.

In some cases, an entity may have an **obligation to issue a variable number of shares**. These are reported as liabilities when the monetary value of the shares the entity will be required to issue is based on:

- A fixed monetary amount such that the number of shares will be determined essentially by dividing that amount by the fair value per share at settlement; or
- An index other than the fair value of the entity's equity shares, such as a financial instrument that is indexed to the Dow Jones Industrial Average; or
- A relationship that varies inversely to the fair value of the entity's equity securities, such as a written put option that can be satisfied by net share settlement.

Equity securities of an entity that are reported as liabilities are not considered in the calculation of earnings per share. This includes mandatorily redeemable securities as well as forward contracts, such as put options, to repurchase equity shares.

When all the shares of an entity are mandatorily redeemable, all will be reported in the liability section, identified as shares subject to mandatory redemption. As a result, there will be no stockholders' equity section and amounts for common stock, APIC, and retained earnings are disclosed.

A closely held corporation is formed by 5 friends, and a single class of common stock is issued. There is a provision requiring the corporation to repurchase the shares of any shareholder who dies by the payment of cash equal to the net book value of the shares on the latest financial statement date prior to the death. In such a circumstance, the common stock is treated as a liability. The balance sheet might appear as follows:

Five Buddies Corporation

Total Assets	$10,000,000
Liabilities other than shares	$ 3,000,000
Shares subject to mandatory redemption	7,000,000
Total Liabilities	$10,000,000